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Supply Chain e-Business — June, 2001

## The Supply Chain e-Business Top 100 Buy: Moving from Indirect to Direct Procurement

Jim Kilpatrick, Principal Global Supply Chain Practice Leader, Deloitte Consulting

A lot has happened in the world of procurement solutions over the past couple of years. Companies moved beyond the basic procurement transaction functionality offered by their core enterprise resource planning (ERP) applications and have begun to assess web-based applications, particularly in the area of indirect "e-procurement".

A recent survey of trends and issues in e-sourcing and e-procurement conducted by Deloitte Consulting, provides the following insights:

- E-business has moved from talk to execution. This year, more than two thirds of companies report have a formal e-business strategy, almost double the previous year. These companies tell us that they have begun the long process of integrating e-business within their organization and across their supply chain. Business-to-business (B2B) procurement is often the first step in this journey.

- More than 90 percent of respondents report that they are implementing or plan to implement an e-procurement solution. Business leaders are using the success of e-procurement implementations as the springboard to more broad-based B2B implementations.

- E-procurement projects are very focused on cost reduction and they appear to be delivering. Typical business cases identify five-to-fifteen percent cost reduction potential depending on the "commodity" and over 50 percent of the companies that have implemented e-

procurement technology believe that they are on-track to meet or exceed their business benefits expectations. In addition, companies are finding that extending their e-procurement vision to include e-sourcing or to move beyond indirect materials can substantially enhance the benefits that can be attained.

- Early implementations were hampered by a lack of supplier readiness, although this issue appears to be disappearing. In fact, the majority of suppliers indicate that they are receiving benefits from e-procurement implementations (versus simply getting pressured by customers to reduce margins) and they are starting to leverage e-catalogs and reverse auctions as a means to improve their competitive performance.

*"Less than 20 percent of the Global 1000 corporations have implemented their e-procurement solution."*

— Jim Kilpatrick, Deloitte Consulting

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### **Growth ahead**

Despite all the activity in the e-procurement space, particularly over the past year, there still appears to be tremendous opportunity for the procurement solution providers. A very small number of companies have completed their e-procurement initiative. Instead, most e-procurement implementations are still in the pilot stage, embracing a few commodities, a few suppliers, and small segment of the user population. Recent surveys indicate that less than 20 percent of the Global 1000 corporations have chosen and implemented their e-procurement solution. Other surveys indicate that perhaps less than five percent of the e-procurement market opportunity has been captured, sighting the opportunities both internationally and in the mid-market (companies below \$1 bn in annual revenues). In fact, the market for e-procurement software is predicted to grow from approximately \$50 mn in 1997 to approximately \$2 bn in 2000 to over \$10 bn by 2005.

### **Pick your project**

What is the typical e-procurement project? Actually, there is a very wide range of project characteristics, driven by geography (e.g., U.S. versus global), number of users, number of suppliers, and degree of change from the current procurement process. In any event, these initiatives are significant. Project budgets typically range from \$2 mn to \$10 mn (solution, integration, consulting), with implementation teams of three to 13 people and project durations of one to three years.

At last scan, there are well over 200 procurement solution providers, with Ariba leading the pack followed by Commerce One as the two vendors on almost everyone's shortlist. They vaulted far in front of the pack using first mover advantage combined with very good software. However, while it was possible to implement indirect materials procurement solutions in a relatively "stand-alone" manner, direct materials procurement will require much better management of the total supply chain. As a result, each company is currently evaluating their supply-chain partners, Commerce One building a strong relationship with SAP. Ariba, after a failed acquisition of Agile and the end of their partnership with i2 Technologies, is looking to establish a network of partners in the area of supply chain management.

### **The partnering option**

There may still be significant opportunity in the indirect e-procurement space, as illustrated earlier, but the path to longer term success will likely be based on either building stronger supply chain functionality or partnering with other solution providers to bring a total solution to their clients.

This presents a very interesting challenge for Ariba and Commerce One as well as an interesting opportunity for other vendors that provide solutions for sourcing and e-procurement. There are a number of solution providers that have a compelling story to tell. Oracle is one of the top e-procurement solution providers and continues to develop one of the broadest total solutions in the industry, offering a single source for applications that cover the e-procurement space as well as ERP, supply-chain management, and customer relationship management (CRM). i2 Technologies' recent acquisition of Rightworks, combined with their earlier acquisition of Aspect Technologies and SupplyBase provides them with perhaps the deepest supplier relationship management (SRM) suite of products in the industry and a compelling story around both indirect as well as direct procurement. FreeMarkets, with the recent acquisition of Adexa provides an interesting combination of sourcing expertise and solutions that can cover a broad spectrum of procurement needs, from indirect to direct materials. Companies such as MRO Software have staked out niche territories (in this case the sourcing and replenishment of maintenance items) with

deep domain expertise to help their clients unlock the benefits in their procurement processes.

### **Vendors to watch**

And, there are a number of up-and-comers to watch:

- Agile, which was almost acquired by Ariba, produces very strong solutions for direct materials procurement as well as solutions to manage product content and collaborate with trading partners over the internet.
- Emptoris, that provides an interesting electronic procurement application for request for quote and request for proposal (RFP/RFQ) creation, analysis and award management. One of the differentiating factors of their web-based application has been optimization-based decision support for bid analysis. Customizable business rules and unconstrained bundling and volume discounting enable improved outcomes for both buyers and suppliers.
- ICG Commerce, who recently merged with Accenture's sourcing division (ePvalue) to provide a company capable of providing e-procurement solutions and services. With ICG's recent sale of Rightworks to i2 it is still unclear what business model they will eventually adapt but they may be the first to make the application service provider (ASP) model work in this space.
- Manugistics, while well-known for its planning applications, also provides solutions for direct materials planning. It could easily copy i2's move and acquire extended sourcing and e-procurement functionality and be positioned as a key player in the direct materials procurement space.
- NexPrise, which builds solutions to enable companies (customers, suppliers, and other trading partners) to collaborate on complex processes customer as collaborative procurement and collaborative product development.

Most e-procurement implementations begin with indirect goods and services. While the procurement of indirect goods and services, for most companies, is not the largest opportunity to reduce cost, it can provide significant savings at relatively low risk:

- Indirect materials procurement has typically been over-looked, as procurement departments have spent more time on sourcing and negotiating contracts for direct materials.
- Indirect e-procurement is a logical and necessary compliment to strategic sourcing initiatives, providing a technology to drive compliance to the negotiated contracts and reduce maverick spending.
- Indirect materials and services (office supplies, computer hardware, office equipment, computer software, printing, travel, temporary services, etc.) and maintenance, repair and operating (MRO) materials (safety supplies, janitorial supplies, spare parts, etc.) are often procured outside the formal purchasing organization. There has typically been a lack of user-friendly tools to support this process.
- Indirect procurement typically involve streamlining lower per-transaction purchases over a significant spend base, thereby yielding significant process improvements.
- As a learning experience, mistakes in indirect procurement are not nearly as costly as mistakes in procuring MRO or direct materials.

### **Direct is more complex**

It many cases, it still may make sense to start with an e-procurement implementation focused on indirect materials. However, it is now apparent to most companies that far greater value can be achieved by focusing on the relationships with suppliers of direct materials. The challenge is that direct material e-procurement adoption and business models are relatively immature. While a number of vendors have made great progress in building solutions for this area of the business, direct materials e-procurement technology solutions are currently limited in functionality and niche focused (fragmented). However, emerging technology standards and development environments are leading to fast, iterative and best-of-breed approaches to building these e-procurement solutions that can provide those companies that are successful in implementing these solution with long term competitive advantage.

#### **An e-procurement plan**

So, how do you move forward?

1. Start by making sure that you have a procurement strategy that considers you overall corporate objectives and covers all aspects of spend – from indirect to MRO to direct materials. Recognize that procurement is not simply a process to reduce cost but a critical element of your competitive advantage including stronger supplier partnerships, faster response time, improved control, and bottom-line cost savings.
2. Conduct a thorough analysis of your spend, including both indirect and direct materials and services, to understand your actual spend levels and supplier fragmentation.
3. Map your major spend categories to B2B enablers, both e-sourcing (e.g., e-RFQ submission & evaluation) and e-procurement (e.g., purchase transaction processing). Consider that multiple solutions may be required to get the best results (e.g., on-line reverse auction to negotiate price and e-procurement catalogue to streamline purchase to payment transaction process).
4. Consider how you will leverage a portfolio of e-marketplaces and on-line trading exchanges. While public exchanges have received most of the press, positive and negative, over the past year, many companies today are looking to implement private exchanges as a means to improve the manner in which they interact with their key suppliers.
5. Evaluate the tools on the market and develop an overall B2B application architecture that will enable your company to e-enable your procurement and sourcing processes. Recognize that while one vendor may be able to meet your needs one solution won't. You will need to consider e-sourcing platforms, e-procurement solutions, contract management solutions, supplier collaboration solutions, and content management solutions.
6. Assess the organizational impact of implementing e-procurement solutions. Remember that implementing the new technologies is relatively easy. However, building organizational capabilities, aligning policies and metrics, and building buy-in to the new ways of doing business are hard.
7. Leverage opportunities to pilot the new technologies and processes. Use these pilots to build understanding within your organization and transition thinking from "what's required?" to "what's possible?"

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